

May 8, 1998

## **Estimating the Revenues of S. 1415, the Tobacco Bill**

**RPC Addresses Reasons for Conflicting Estimates, and Offers its own Estimates**

By any estimation, S. 1415 would amount to one of the largest increases in federal revenues in recent years. The multiplicity of the revenue-raising provisions (five primary ones), the complexity of these mechanisms (including inflation adjusters and sales reductions estimates), their extended duration (at least 25 years), and inconsistencies within the bill itself combine to make revenue estimates complex. It is not surprising, then, that conflicting estimates have begun to appear and, because of the underlying sums and duration, that these differences can amount to hundreds of billions of dollars.

RPC conducted its own examination of the bill, presented here. [See attached Revenue Table.] Because of the differing revenue-raising provisions and the various circumstances under which they would operate, we present a range of estimates as the most effective method of estimating the revenues of S. 1415. (The high estimate assumes assessment of the maximum penalty, adjusted for inflation, for failure to reduce youth smoking; the low estimate assumes no assessment of so-called look-back penalties.) Further, this estimate assumes only those changes stipulated in the legislation. The following is an explanation of RPC's estimates and comparisons.

- Over the first 5 years, revenues would range from \$102.1 billion to \$109.9 billion.
- In the first 10 years, revenues would range from \$231.2 billion to \$260.4 billion.
- Over the 25 years, revenues would range from \$755.3 billion to \$868.9 billion.

*\* The Commerce committee claims that these totals would be lower had the reported bill not contained a drafting error.*

### **The Revenue Streams**

S. 1415 creates the National Tobacco Settlement Trust Fund (Section 401, page 397), and then stipulates five distinct revenue sources for it. The description below lists them as they appear on the included revenue table (all citations are from the text of S. 1415 as reported from the Commerce Committee).

- **One-time payment** (column 2 of Revenue Table): An initial \$10 billion payment must be made by the participating tobacco producers (Section 403(a), page 401).
- **Annual payment** (column 3 of Revenue Table): The bill calls for annual payments, beginning at \$14.4 billion in the first year and increasing to \$23.6 billion in the fifth year and thereafter (Section 403(b), page 403). [The Commerce committee states that a drafting error undermined their intent that, after the five fixed annual payments, the sixth payment should be the fourth year fixed payment inflated (as stipulated below) and that the remaining years would proceed from this base. If changed this would have consequences for the out-year totals.] These payments are to be adjusted as follows:
  - **Inflation adjuster** (column 8 of Revenue Table): Section 404(1) stipulates that “the amount of the annual payment made for the preceding year increased by the *greater of* 3 percent or the inflation adjustment” (page 407, emphasis added). The inflation adjustment is the CPI-U. Since the CPI-U is estimated to be below 3 percent by both OMB and CBO over each of the years in the FY99-03 period, the 3-percent figure has been used to inflate the payments.
  - **Volume adjuster** (not included in Revenue Table): Section 404(2) stipulates that “Beginning with calendar year 2005, the applicable base amount (as adjusted for inflation under paragraph (1)) shall be adjusted for changes in volume of domestic sales by multiplying the applicable base amount by the ratio of the actual volume for the preceding year to the base volume. . . . [T]he term ‘base volume’ means the number of units of tobacco products sold domestically by the participating tobacco product manufacturers in calendar year 1996....” (pages 408-9). *Because the “volume adjuster” could go either way, we have chosen to disregard it in our calculations.*
- **Look-back penalties** (column 4 of Revenue Table): Beginning in the fourth year after enactment, so-called look-back penalties may be assessed on the industry if stipulated reductions in youth smoking have not been met (Section 202, page 346). These penalties are to be assessed on the percentages of nonreduction of youth smoking with the maximum base penalties set at \$3.5 billion for cigarettes and \$0.35 billion for smokeless tobacco — \$3.85 billion in total. These penalties are also subject to inflation adjustment:
  - **Inflation adjuster** (column 9 of Revenue Table): Section 202(4)(B) stipulates that the look-back penalties are to be adjusted for inflation as calculated by the CPI-U (page 349-50). In order to take a non-biased estimator, we have chosen to use the Blue Chip estimate for inflation and then continued the estimate for 2003 (2.7 percent — an historically low rate) for all the years through 2023.
- **Pass-through penalties** (column 5 of Table): Section 405(b) stipulates that “a penalty against that manufacturer in an amount equal to (A) 110 percent of the shortfall; or (B) if the failure to comply...was intentional, up to 125 percent of the shortfall amount” (page 409) for failure to pass-through the industry assessments to the consumer in the price of its products. *Because there is no way to estimate whether or how this will occur, it has been left out of the revenue estimate.*

- **Enforcement of nonpayment penalties** (column 6 of Revenue Table): Section 407(a) stipulates that "Any participating tobacco product manufacturer that fails to make any payment required under section 403 or 405 within 60 days after the date on which such fee is due is liable for a civil penalty of \$100,000 for each day during the noncompliance period (page 411)." *The bill provides no penalty will be imposed under section 403 if the failure was not willful neglect, and since there is no way to estimate whether or how this penalty will be assessed, it has been left out of the revenue estimate.*
- **Licensing Fees** (not included in Revenue Table): Section 1121 stipulates that an "annual license fee shall be \$1 per every 1000 cigarettes manufactured, or distributed for sale, by a domestic concern either directly or through its foreign subsidiaries, affiliates, joint ventures, or licensees and an equivalent amount, as established by the Secretary, for other tobacco products" (page 600). *Because this money will be deposited into a separate trust fund, the International Tobacco Control Trust Fund (Section 1131(a), page 601) from the National Tobacco Settlement Trust Fund being analyzed here, it has been left out of the revenue estimate. Also, we understand that the Commerce Committee is currently negotiating changes in this section.*

## The Revenue Totals

As stated earlier, the best estimate of the revenue totals must constitute a range of totals. For our purposes, we have chosen to list what would be the lowest base payments stipulated by S. 1415 and what would be the highest — assuming only the maximum look-back penalties. Thus, our "high" estimate is not as high as it could be if it included any estimates for the pass-through penalties, enforcement of nonpayment penalties, or license fee, or if we had used a less conservative (but historically more realistic) inflation adjuster for the look-back penalty [see above discussion for details on this topic].

- The five-year total ranges from \$102.1 billion (comprised of the one-time \$10-billion assessment + annual payments of \$92.1 billion) to \$109.9 billion (previous total + maximum look-back penalty of \$7.8 billion).
- The 10-year total ranges from \$231.2 billion (comprised of the one-time \$10-billion assessment + 10 years of annual payments amounting to \$221.2 billion) to \$260.4 billion (comprised of the previous total + maximum look-back penalty of \$29.2 billion).
- The 25-year total ranges from \$755.3 billion (comprised of the one-time \$10-billion assessment + 25 years of annual payments amounting to \$745.27 billion) to \$868.9 billion (previous total + maximum look-back penalty of \$113.65 billion).
- As noted above, the Commerce committee states that an inconsistency in the bill language undermines their intention that there are five fixed payments and that beginning in the sixth year the payment would be calculated by inflating the fourth fixed payment — if changed this could have substantial consequences, especially in the out-years, as follows: the five-year range would be from \$102.1 billion to \$109.9 billion with the maximum look-back penalty; the ten-year range would be from \$216.9 billion to \$246.1 billion with the

maximum look-back penalty; and the 25-year range would be from \$673.3 billion to \$796.95 billion with the maximum look-back penalty.

## **Comparison with OMB Estimates**

RPC's estimates contrast somewhat with those made by the Administration's Office of Management and Budget. The agency acknowledged the base payment figure of \$755.9 billion (virtually identical with the RPC 25-year current dollar estimate) over 25 years in a May 1, 1998, letter to Chairman McCain. However, it also has produced much lower estimates by: (1) eliminating the effects of inflation on the payments (despite the fact that inflation adjusters are expressly included in the legislation), and (2) by assuming the targets for reductions in tobacco consumption are met — particularly in youth smoking.

These distinctions in methodology allow OMB to produce a \$516 billion estimate over 25 years *in constant 1999 dollars*. Where OMB diverges from our estimates is in its attempt to make several manipulations to the totals — particularly in the high range of the estimates:

- ▶ OMB attempts to use a constant (1999) dollar figure. However, there are several reasons for not doing this: 1) Consistency with conventional estimates — Congress generally does not use constant dollar estimates in calculating its budgets, tax bills, etc.; 2) Americans don't earn or pay constant dollars — this method of calculating does not reflect actual pocketbook expenses as taxpayers would experience them; and 3) S. 1415 expressly stipulates the use of detailed inflator mechanisms — and so disregarding these mechanisms is disregarding the legislation that is attempting to be estimated.
- ▶ OMB drops the look-back penalty from its calculations entirely — thereby assuming full compliance with the bill's requirements for reductions in tobacco consumption. While we present our estimates as a range into which the total revenue would fall, OMB presents its estimates as though the look-back were not part of the legislation at all. This is inaccurate and could result in not counting up to 30 percent of the total revenues that S. 1415 could raise.

## **Comparison with Original Tobacco Settlement**

The original tobacco settlement between the tobacco companies and the State Attorneys General was \$368.5 billion in constant dollars. According to OMB estimates provided to the Commerce Committee — inflating this into current dollars and adding in a maximum look-back penalty (as done to compute the high-end of the range) — the five-year range would be \$72.7 billion (there were no penalties in the first five years); the ten-year range would be from \$165 billion to \$177.3 billion; and the 25-year range would be from \$539.9 billion to \$602.2 billion.

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Attachment: RPC Revenue Table

**Tobacco Bill (S. 1415) Revenue Streams  
Into the National Tobacco Settlement Trust Fund  
(in billions of dollars)**

Year	One-time Payment	Annual Payment	Lookback Penalties	Pass-through Penalties 110%-125% of shortfall	Enforcement: Nonpayment Penalty: \$100,000/day after 60 days	Inflation adjuster for Annual Payment	Inflation adjuster for Lookback Penalty	GRAND TOTALS
1999	10	14.40				1.03	1.025	24.40
2000	NA	15.40		?	?	1.03	1.027	15.40
2001	NA	17.70		?	?	1.03	1.027	17.70
2002	NA	21.00	3.85	?	?	1.03	1.028	24.85
2003	NA	23.60	3.95	?	?	1.03	1.027	27.55
2004	NA	24.31	4.06	?	?	1.03	1.027	28.37
2005	NA	25.04	4.17	?	?	1.03	1.027	29.21
2006	NA	25.79	4.28	?	?	1.03	1.027	30.07
2007	NA	26.56	4.40	?	?	1.03	1.027	30.96
2008	NA	27.36	4.52	?	?	1.03	1.027	31.88
2009	NA	28.18	4.64	?	?	1.03	1.027	32.82
2010	NA	29.03	4.76	?	?	1.03	1.027	33.79
2011	NA	29.90	4.89	?	?	1.03	1.027	34.79
2012	NA	30.79	5.03	?	?	1.03	1.027	35.82
2013	NA	31.72	5.16	?	?	1.03	1.027	36.88
2014	NA	32.67	5.30	?	?	1.03	1.027	37.97
2015	NA	33.65	5.44	?	?	1.03	1.027	39.09
2016	NA	34.66	5.59	?	?	1.03	1.027	40.25
2017	NA	35.70	5.74	?	?	1.03	1.027	41.44
2018	NA	36.77	5.90	?	?	1.03	1.027	42.66
2019	NA	37.87	6.06	?	?	1.03	1.027	43.93
2020	NA	39.01	6.22	?	?	1.03	1.027	45.23
2021	NA	40.18	6.39	?	?	1.03	1.027	46.56
2022	NA	41.38	6.56	?	?	1.03	1.027	47.94
2023	NA	42.62	6.74	?	?	1.03	1.027	49.36
5-YEAR	10	92.10	7.80	?	?			109.90
10-YEAR	10	221.15	29.23	?	?			260.39
25-YEAR	10	745.27	113.65	?	?			868.91

Annual Payments assume a constant volume after the 6th year and are not adjusted for changes (which could either decrease or increase the annual payments) as stipulated in Sec. 404(2)

\* As noted above, the Commerce Committee states that an inconsistency in the bill language undermines their intention that there are to be five fixed payments and that beginning in the sixth year the payment would be calculated by inflating the fourth-year fixed payment – if changed this would alter the out-years, as follows: the five-year range would be from \$102.1 billion to \$109.9 billion with the maximum look-back penalty; the ten-year range would be from \$216.9 billion to \$248.1 billion with the maximum look-back penalty; and the 25-year range would be from \$873.3 billion to \$798.95 billion with the maximum look-back penalty.